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The Province of Alberta

IN THE MATTER OF "THE NATURAL GAS UTILITIES ACT"

—and—

IN THE MATTER OF an Enquiry into Scheme to be adopted for Gathering, Processing and Transmission of Natural Gas in Turner Valley

---

G. M. BLACKSTOCK, Esq., K.C., *Chairman*

Dr. E. H. BOOMER, F.C.I.C., *Commissioner*

Session:

CALGARY, Alberta September 13th, 1945

VOLUME 39

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Volume 39

13th September, 1945.
9.30 A.M. Session

MR. CHAMBERS: I believe Mr. McDonald has some cross-examination.

THE CHAIRMAN: Were you not re-examining when we adjourned?

MR. CHAMBERS: No, I had not started.

CROSS-EXAMINATION OF THE SAME WITNESS BY MR. McDONALD.

Q Mr. Baker, there seems to be some difference of opinion as between what you consider a return on the investment of the funds of a company and the return on the investment as referred to in this judgment of Mr. Justice Lamont that you have set out in the commencement of your brief. Would my illustration be your conception of the thing? If Royalite took $678,000 and invested $1000 in each one of the 678 companies referred to in the statistical returns; and in the year 1943 each of these companies paid by way of a dividend all of the net income of the company after allowance for depreciation and depletion which would be retained by the company, then Royalite would receive 9.04 per cent on the investment of $678,000. That is your illustration.

A Yes, if each of these companies paid all of their net earnings out by way of cash dividends.

Q Well I will give you another example and then we might argue from that. There is currently running in the Financial Post two accounts, two investment accounts. They call them the MacNab Account and the Compton Account. They were commenced on December 16th, 1944. They are what you call theoretical investment accounts as illustrations of how an investor might get a return if he followed the procedure outlined by the management of those two accounts.

I take it that they are being operated in theory by two different financial counsel for purposes of illustration. Now I see that the MacNab Account . . . . .

MR. CHAMBERS: Which paper are you referring to?

MR. McDONALD: The Financial Post.

MR. CHAMBERS: What date?

MR. McDONALD: December 16th, 1944.

Q MacNab is to obtain for the investors the maximum income consistent with safety of capital and the Compton Account wants income but he also hopes to enlarge it. His aim is about 50-50 between income and capital appreciation. In other words, one is more speculative than the other.

A Yes.

Q Now I see, if you will just look at this, what is the rate of return, the average rate of return that on that date the MacNab Account would earn?

A It says here 4.42 per cent.

Q What is the average rate of return that the Compton Account would earn on that date?

A It says here 3.94 per cent.

Q Would you look at those securities that are listed in these statements and tell me if they are a fair average investment in Canadian industrial and speculative stocks?

A Yes, they are hand picked.

MR. McDONALD: I tender that, Mr. Chairman, Financial Post dated December 16th, 1944.

FIRST PAGE OF THE SECOND SECTION IS NOW MARKED EXHIBIT 112.

Q Could you tell me if there are any public utilities in those lists, Mr. Baker?

A Yes, quite a few.

Q Could you just name a few of them, just to illustrate?

A Well there is Bell Telephone.

Q Yes.

A Winnipeg Electric, Montreal Light, Brazilian Traction. Is that enough?

Q Yes, that would be fine. Now we will take Winnipeg Electric. Is Winnipeg Electric financed on a composite scheme of a bond issue, preferred stock and common stock, or which of the three?

A All three.

Q All three, yes. Bell Telephone, is that all three?

A Two.

Q What two are those?

A Bonds and common.

Q Now I take it what is referred to here are common stocks. Maybe you had better look. I just have not checked. No, I think Winnipeg Electric is preferred is it not?

A Winnipeg Electric is preferred, yes. Bell Telephone is common, Brazilian is common and Montreal Light is common.

Q Now can you tell me if that Winnipeg Electric preferred is a guaranteed rate of interest?

A Oh no. What do you mean by guaranteed?

Q Is it preferred 6% cumulative?

A I do not think it is. I have forgotten.

Q Well I do not know. But it is the secondary security, anyway, on all the assets of that company?

A Yes.

Q That is why it is preferred?

A Yes.

Q Now can you tell me what is the rate of interest on the Winnipeg Electric bonds?

A The rate of interest?

Q Yes.

A 5 per cent.

Q Would it be a fair assumption that the preferred stock is preferred to a dividend rate of 6%?

A No, because it says 5 here.

MR. CHAMBERS: I do not think he got the question.

A It says 5 here.

Q MR. McDONALD: That is 5 per cent preferred?

A Do you want me to say 6?

Q No, whatever is there, that is what I want.

A That is all it says here, 5 per cent.

Q Preferred stock?

A Yes.

Q Oh yes. In fixing your rate of return for a public utility, the rate of return fixed by this Board or any other governing body is the gross rate of return from which the bond interest, 5% or whatever it is, is paid and then the preferred stock interest is paid and whatever is left then goes to the common stock, is that not so?

A Yes, after all other charges, yes.

Q Now do you know whether Winnipeg Electric common has earned a dividend?

A They have not paid one. They might have earned one but they have not paid one.

Q Now then I think I put it right when I say this that the rate of return earned on these two accounts or the stocks listed in those two accounts of 4.42% in one and 3.94 in the

other is the amount of money or the rate of return fixed by the various Boards of Directors.

A Fixed what?

Q Fixed by the various Boards of Directors.

A The rate of return?

Q No, the amount of money that is referred to in that percentage. The various Boards of Directors have declared a dividend.

A Well, Boards of Directors do not. It is by contractual obligation on the bonds and after that on the preferred. After that on the common, that is the decision of the Directors, yes.

Q But on common stock a dividend is declared by the Board of Directors. It is not a matter of contract, the question of common stock.

A In some cases, quite a few cases, it might have to be qualified by their bylaws. In other words, they might not be able to pay dividends until their working capital has reached a certain point. They might not be able to pay dividends until certain charges have been met prior to that. They might have to anticipate. It is by the Board of Directors after that.

Q Do you think in most industrial companies that they pay out their entire net income in dividends?

A Beg pardon?

Q Would you say that most Boards of Directors pay out by way of dividends the entire net income of the company?

A I know companies that do, yes.

Q But in that list of companies referred to in those two accounts?

A No, I cannot say that I am aware of any of those companies paying out their entire net income. It could be but I do

not know.

Q In other words, the income of the companies, as you have referred to in your evidence, is only partly paid out in dividends?

A Cash dividends?

Q Yes.

A Yes.

Q And partly retained in the company?

A Yes.

Q In surplus accounts or in special accounts for reconversion or something of that kind?

A That is right.

Q Just while we are dealing with dividends, reference was made yesterday to the Royalite Company having paid a dollar dividend in the year 1944, for instance, and reference was made to the fact of the stocks having a market value of $20.00 which would give a rate of 5%. Now can you recollect what the market value of Royalite stock was say in 1933 or 1934?

A No. I have got it here, but I cannot recollect it.

Q Well if you have it would you tell me?

A What year?

Q 1933.

A Oh, 1933, I do not go back that far.

(Go to page 2979)

Q Oh, 1933?

A Oh, 1933, I did not go back that far.

Q How far back do you go?

A I go back to 1938.

Q What was it in 1938?

A In 1938 was $43.00.

Q Well now, from your experience in the market can you tell me in what year the Royalite stock had been freely traded in under $10.00?

A In what year was it what?

Q Being freely traded in under $10.00 per share, have you any recollection of that?

A No, I cannot go back that far.

Q I am going to suggest to you in that year or in those years the Royalite dividend was not a dollar but was a dollar and a half a share?

A A dollar and a half in 1938.

Q Yes, but the stock was up to $43.00; now would you say that there is any real connection between the market price of the stock and the amount of dividend which has been paid by the Royalite Oil Company from time to time?

A Not necessarily.

Q I suggest as a financial counsel that you would recommend to a purchaser of stock of the calibre of Royalite that it would be a good purchase because t s a subsidiary company and there will be or could be anticipated a regular dividend payment because of the fact that the parent organization requires the income from its subsidiary, would that be sound advice?

A It would be a factor.

Q Yes?

A In giving the advice, yes.

Q Yes, and I suggest to you that the dollar rate of dividend which is maintained in Royalite is maintained partly to maintain the income of the Imperial Oil Company?

MR. CHAMBERS: Are you putting that to him as a fact?

MR. McDONALD: I am suggesting to him that that would be a factor.

MR. CHAMBERS: Then you are asking him to assume that that is a factor?

MR. McDONALD: Yes.

Q MR. McDONALD: Is that a factor?

A Repeat that, will you?

Q Is it a factor in maintaining the dollar rate of income for the Royalite Company?

A A subsiduary earning?

Q Subsiduary earnings, yes.

A It could, yes.

Q And that is also true of the Consolidated Mining & Smelting Company of Canada Limited, a subsidiary of the Canadian Pacific Railway Company.

A I never heard of the Consoludated Mining & Smelting Company of Canada Limited being a subsidiary of the Canadian Pacific Railway Company, have you?

Q Well I think during the depression years, I think it was the main source of revenue of the Canadian Pacific Railway Company.

A The Canadian Pacific Railway Company owns stock in the Consolidated Mining but I never heard of it as a subsiduary of the Canadian Pacific Railway Company.

Q I will not argue that with you, I do not know, but you will admit that the International Petroleum, Mr. Baker, is a subsid-

iary of the Imperial Oil Company?

A Is it?

Q I think it is in the consolidated balance sheet, although I am not sure.

MR. CHAMBERS: Now if you are going into these things I think you or somebody should go into the witness box.

THE CHAIRMAN: He is suggesting it to the witness and if the witness says "I don't know" there is no harm done, and if he says he does know then he may answer.

MR. CHAMBERS: Then the examiner proceeds to say it is so.

Q MR. McDONALD: No, I do not know, Mr. Baker, do you?

A No, I do not know.

Q Is it in the consolidated balance sheet of the Imperial Oil Company?

THE CHAIRMAN: The Valley Pipe Line Company is another subsidiary.

WITNESS: I would say it is looked upon as being in the Standard family, is that sufficient?

Q MR. McDONALD: That is sufficient. It is not important. Now, Mr. Baker, would you say that the year 1943 was a normal year for Canadian industrial operations?

A I do not think it would be fair to say that any year since the outbreak of war has been a normal year.

Q Now for the purposes of ascertaining excess profits tax, the Income Tax office or Parliament stipulated that the normal year of a corporation or any business would be the average profits earned for the years 1936 to 1939 inclusive, that is generally known?

A Yes.

Q And they called that the "Standard profit"?

A Yes.

Q Now would you say that that profit covering those four years would be a standard, would be, - no, I will put my question this way, would you say that business conditions from 1936 to 1939 inclusive could be considered, when averaged out, would be standard or average business conditions?

A Well it works that way in some cases but I think if youwill discuss that matter with the Board of Referees they will admit that it was most iniquitous in far more cases than they ever dreamed it would be, it was not normal in a great many cases and that is why there was a Board of Referees.

Q There had to be many adjustments?

A Oh, thousands.

Q But on the over-all picture would you say that it was standard?

A That would depend on which side of the fence I happened to be on.

Q THE CHAIRMAN: Well would it be a fair index?

A It was intended to be but it did not turn out to be.

Q MR. McDONALD: The reason I bring that up, Mr. Baker, is this, that what I think this Board should look to is to fix a rate of return that is related to normal business conditions rather than to abnormal business conditions?

A It should try to do that.

Q And I suggest to you that the point to start, I am suggesting to you that the point to start is not the year 1943 but the years 1936 to 1939 inclusive, and average out your rate of return for those years as a basis, what comment have you on that suggestion?

A I have not any on it at all. I think that it would probably

test out, it would surprise me if it was very much different from 1943 because the taxation feature has balanced things out, as you know, pretty well.

Q Yes. Well I mean if the tax feature does balance it out, then the 1943 might be approximately equitable?

A Yes, and I think you might be surprised at what you would find, that is what the taxes are supposed to do.

Q Yes, that is its purpose; do you or do you not know, Mr. Baker, that in connection with special war contracts awarded to numerous industrial concerns, special depreciation allowances have been made in connection with war installations?

A That is right.

Q And the fact that those depreciations were taken at say 50% instead of 15%, would be reflected somewhere in the increased earnings of those companies?

A Cash.

Q Yes, in the case income?

A Well not without cheating.

Q I just wanted your opinion on that, to test your summary. Now can you express an opinion on this suggestion, Mr. Baker, that if in fixing a rate base the Utility Board uses a yardstick which gives to the Utility Company a liberal rate base, that is reproduction costs new say, in a relatively high price year such as 1943, that in fixing the rate of return the Utility Board should fix the rate on a diminishing basis, on a lesser basis than if it had used a more rigid yardstick in making the rate base.

A I wonder if I have been called here to answer that particular question.

Q Well have you an opinion on it? I do not know whether you

feel qualified to answer it or not?

A No, I am not sufficiently well informed to give an opinion on that.

Q From your experience can you tell me, no, I do not think I will pursue that further, - can you express an opinion on the matter of income taxes bearing on the rate of return, do you think you are qualified on that?

A I am not a tax expert.

MR. McDONALD: Thank you.

THE CHAIRMAN: Mr. Steer, do you wish to cross-examine?

MR. STEER: I have nothing, Mr. Chairman.

THE CHAIRMAN: Mr. Harvie?

MR. HARVIE: No.

THE CHAIRMAN: All right then, Mr. Chambers.

.....

RE-EXAMINATION BY MR. CHAMBERS:

Q Mr. Baker, my friend Mr. McDonald has just discussed with you your view as to the relative net earnings of the companies during the war years and prior to those years, and I think you said to him, and correct me if I am wrong, that your view, by and large, was that the extra taxation imposed during the war pretty well evened the thing out for the companies as compared to prior to the war and during the war, am I right in that?

A It was designed to do that.

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Q Well now then Mr. Baker, would you turn to the Bank of Canada's Statistical Summary that you filed yesterday as Exhibit 107 and which is referred to in your Exhibit 106, and as I understand it you take the last column on Page 11 of the Bank of Canada report and you deduct the funded debt and the advances from the Government and loans from parent and other companies and you find that the shareholders funds in the business amounted to $3,251,000,000. Is that right ?

A That is right.

Q And then you took the net earnings after the income tax and applied it to that $3,251,000,000 and the answer was 9.04% was it not ?

A That is right.

Q And that was the net average earnings for the 678 companies for the year 1943. Now, Mr. Baker, I am going to suggest this to you and I know you have not done the figuring, but I have had it figured and I would like you to check this later if my figures are not right. I suggest that if you take the first column, the year 1936, as shown on Page 11 of Exhibit 107, and apply to it the same methods that you used in arriving at your 9.04% for the year 1943, that the figures that you get for 1936 is 8.13, and that if you do the same for the year 1937 you get 10.17, and if you do the same for 1938 you get 8.41, and if you do the same for the year 1939 you get 9.88. Now I am just assuming that you take my figures as correct for the moment and that you take the average of those figures for the years 1936 to the year 1939, both inclusive, that the average is 9.15% as compared with 9.04% for the year 1943.

Now what I am putting to you is this, that that suggests to me and I am asking you whether you agree with me

or not that by virtue of the operation of the excess profits tax and the other war taxes imposed, the net result is more or less that the companies have paid in taxes sufficient moneys which have more or less kept their net earnings after paying taxes about more or less constant from 1936 on during the war years. Do you agree with that assumption ?

A Yes, the scheme of taxation was that no one should make a dollar out of the war. It was designed to prevent that very thing. Therefore net earnings must be more or less the same.

DR. BOOMER: That did not apply to personal income ?

A No you are right, sir.

MR. CHAMBERS: I submit this Board is not sitting on a matter involving personal income.

THE CHAIRMAN: Probably I wish it were.

MR. CHAMBERS: And I also.

Q Now my learned friend Mr. McDonald also put to you some questions as to why it was thought Royalite paid a dollar dividend and also why the Consolidated Smelters paid some other dividends and he suggested to you as I take it that one of the reasons that they paid dividends was so that the parent company would get some of the income. Do you recall that ?

A Yes.

Q Yes. Let me put this to you bluntly. Do you know why the Royalite Company Directors or the Smelter Company Directors happened to adopt the dividend policy that they have. Do you know ?

A I have not any idea.

Q You can conjecture up various things that might influence them. That is as far as you can go. Is that a fair way to put it ?

A That is right.

Q I suggest to you when we are going into the realm of conjecture, I suggest to you this might influence the situation. It has been intimated here that other interests, and it is a fact, engaged in the oil industry control or have a majority share interest in the Royalite Company. That is more or less understood. You know that Mr. Baker ?

A Yes.

Q And that the parent or controlling interest is also interested in the obtaining of oil resources. That is common knowledge is it not. And to a certain extent at least use earnings or their funds in drilling and other development purposes. Is that not right, Mr. Baker ?

A I would assume so.

Q So there are various factors that must influence the Board of Directors of Royalite or any other company in their decision to pay cash dividends or not. That is just a fair way to put it is it not. Now Mr. Baker, turning back to the discussion that took place yesterday. With the terms net earnings that were used. I think that is what you used and the term dividend was used too. Now for the purpose of discussion would you tell me first of all what is your conception of what we mean by the net earnings of a company ?

A The net earnings of a company may be said to be dollars that create a fund, the owners of whom are the partners of the company, that is, the shareholders. That fund is free of any obligation and may be used in any manner without reference to others excepting the partners. It may be disbursed any way at all so long as it is in the interest wholly of the partners of the company, the shareholders.

Q When you speak of partners you speak of, technically they are

shareholders ?

A Shareholders.

Q And when we speak of the Directors they in fact are in your view the agents named by the -

A Trustees for the partners.

Q Now for the purpose of the record would you give me in general words what you understand by the word, or what is your conception of, a dividend, a company dividend ?

A Of what ?

Q Of a dividend. You told us now about net earnings. Now what is your conception of a dividend.

A Well a dividend may be disbursed in all sorts of ways. I think the common conception of a dividend is cash dividend. Another well known dividend is a stock dividend. You may have dividends too disbursed in goods. For instance, the distillers on some occasions gave cases of whiskey. Not recently but they used to. Dividends may be declared in essence in bricks and mortar. You have your net earnings. The Directors may say to the partners, we will pay you ten cents on the dollar of those net earnings in cash. We will give you fractional stock and with the balance of these earnings we are going to build a plant that we hope will develop those funds of yours and in future we may pay larger cash dividends, but the ready reference when people speak of dividends is usually thought of in cash.

Q In what is paid out in actual dollars and cents ?

A Yes.

Q Mr. Baker, I want to put this assumption to you. Suppose you have two companies. We will take your own city of Winnipeg. Suppose you have two companies carrying on business in the

city of Winnipeg and they each have the same amount of shareholders' funds invested in them. They are both in the same line of business and they are both well managed, and they both earn 9.04%. That is their net earnings amount to 9.04% over a period of years. Companies "A" and "B".

Company "A", the directors in their discretion have over the years, instead of paying the 9.04% out in dividends each year, they have adopted the policy of having actually paid out only 6% each year and they have kept the other 3.04% in the business, either in bonds, buildings or something else of that nature. That is Company "A".

Now you take Company "B". The only difference is that Company "B" has adopted the policy - its directors - over a period of years of paying out to its shareholders each year the full net earnings. In other words 9.04%. Now we will come down to today. That is the situation of the company.

(Go to Page 2990)

Q What I am putting to you is this, that in the event of the shareholders of those two companies, and they both want to sell at the same time, which company would get the most for its undertaking?

A "A" because it would have more assets.

Q THE CHAIRMAN: But is not that only a deferred payment of your dividends?

A If the companies come up for sale, "A" would be better than "B".

Q But that is only a deferred payment of your dividends?

A Yes, exactly.

Q MR. CHAMBERS: In other words, company "A" that has not paid out all its money in dividends, if that company sold out and the money divided among the shareholders, they are getting more in cash now because they have not taken it out as much in dividends earlier, and that is a fair way to put it, is it not?

A Yes.

Q THE CHAIRMAN: Or put the same problem in another way, if one company pays small dividends and creates large reserves, either in cash or by putting profits into additional assets, you get a capital addition, and you can sell the one and get your capital that way. It results in capital appreciation, does it not?

A Well, you will have to qualify that, I think, because marketability does not always exist, particularly, as you know, in small private companies.

Q Quite right.

MR. CHAMBERS: I do suggest, Sir, in view of some of the arbitrary provisions of the Income Tax Act that does not necessarily follow now. For instance, I have in mind the provision where the company makes the distribution of its

surplus, or if the company has any surplus on hand, any distribution of its assets is presumed to be a dividend.

THE CHAIRMAN: That is right.

MR. CHAMBERS: What I am saying is this, if my property is to have a value on present day values I am entitled to have my rate of return fixed on present day earnings.

Q Mr. Baker, I suggest to you on the discussion that you have heard and we have had here just now, that it illustrates in concrete form the difference between net earnings and dividends, the implications are such that we have just illustrated, is that right?

A It what?

Q It illustrates the difference between net earnings and dividends of any one company, that I have illustrated to you, or rather that in the one company that I have illustrated to you the net earnings and the dividends were the same, and in the other the net earnings and the dividends were substantially different.

A Cash.

Q Yes, cash dividends I am talking about. Now, would you turn, Mr. Baker, for a moment to your report, Exhibit 106, the first report that you read yesterday, and in the first paragraph, which is the quotation from the Supreme Court of Canada, as I understand your evidence, it is this, that assuming that is the test, in your opinion applying what you understand by that test, this rate for the Madison Company should be 9½, is that a fair way to put it?

A That is right.

Q Now then, am I right in this, that in your application of that definition you do not in your interpretation, whether you are right or wrong, you do not read into that or imply, just follow

the wording:

> "By a fair return is meant that the company will be allowed as large a return on the capital invested in its enterprise (which will be net to the company) as it would receive"

and then you do not read into it, as I understand it, "by way of cash dividend"?

A No, certainly not. I do not.

Q And probably that is some of the difference between us, but that is your view anyway, Mr. Baker, am I right in that?

A That has always been my view of it or I would not have used that definition.

Q And you say that by virtue of the Bank of Canada statistics the average net earnings for Canadian corporate industry is 9.04%, that is the first step.

A Yes.

Q And then, as I understand it, you say that the shareholders or that Madison itself, this particular company, Madison, is entitled to a net earning higher than 9.04, you say that?

A Exactly.

Q One of the reasons, as I understand it, for you saying why this Madison should have a net earning higher than the average, is Clause (d) on page 2 of your report, in which you say:

> "Should the field peter out ahead of the estimated life, or adjacent fields as close or closer to Calgary develop such as Jumping Pound, a new and cheaper fuel developed, or social changes result in a shift in population, this company would lose justification for its continued operation."

You say that is one of the reasons why this company should have

e net earning higher than the average?

A That is right.

Q Yes. As I also understand you, you correct me if I am wrong, that that quotation from your report which I have just read, also leads you to your conclusion whereby in your opinion this business is not suitable to be financed by a bond issue, is that right?

A That is probably the major factor.

Q Now have you any other factors in mind?

A Well, as I say, marketability, finding buyers.

Q Let me put this to you - by the way , you know from the Press and from following the developments in the West, that various oil companies including the larger American oil companies, are engaged in exploration work for oil and gas in Alberta?

A Yes I know that.

Q Yes. Let me put this to you: Assume that at some period in the next few years, ten years from now, or five years from now, gas in sufficient quantities, natural gas, could be obtained at Jumping Pound or nearer to Calgary, or on the North Hill, outside of Calgary, as a result of which gas could be supplied to the citizens of Calgary at a rate lower, substantially lower, than this gas from the Madison system, and assume that the Calgary Gas Company said "We are not buying gas any more from Turner Valley," have you any idea.....

THE CHAIRMAN: I want you to put one other assumption as well, Mr. Chambers, if you please.

MR. CHAMBERS: Yes.

THE CHAIRMAN: And assuming that Royalite does not go to the Legislature for protection of its Turner Valley market or a share of it.

MR.CHAMBERS: Now, Sir, that is not my assumption. If you want to put that to him, I submit you can do it, because I say that is an assumption that cannot enter. I mean, we may go to the Legislature, but what happens there, then youwould have to assume that the Legislature does not protect us as well.

THE CHAIRMAN: Put that in as another element.

Q MR. CHAMBERS: Bur, Mr.Baker, as far as my question is concerned, and with deference, you can ignore the Legislature for a moment?

A Well can I?

Q Well, I am asking you for the purposes of my proposition to do that. Now, can you give me any idea what would be the value or the realizable value by Madison from its equipment down there in Turner Valley?

A I could not give you any idea of the value. I am not an engineer. But I would not like very much to have to take care of a foreclosed bond issue, as I said yesterday, because it would seem to me that you would be trying to sell a plant on a buyers' market and from what I learned of the hazards of this business, it would seem to be a pretty difficult thing to do. But as to the value I could not give you that.

Q That is all, Mr. Baker. Will you answer the members of the Board please?

MR. FENERTY: May I ask one question on this statement here?

THE CHAIRMAN: Yes.

MR. FENERTY: I do not want to take too long.

.....

RE-CROSS-EXAMINATION BY MR. FENERTY

Q Mr. Baker, dealing with this exhibit 107, the Statistical Summary of the Bank of Canada?

A Yes sir.

Q In the second group of figures under the heading "Use of Funds" we find, do we not, what actually becomes of the undistributed profits as well as the other income of the company, not included in net income, that is right?

A Yes.

Q And if you will look at the fourth column, in the first group, "Depreciation Charges" and compare them with the first column in the second group "Investment in Plant, Property & Equipment" you will find, will you not, that excepting the years 1936 and 1937, the amount invested in Plant, Property & Equipment falls very much below the depreciation charges. For instance, look at 1941, depreciation charges 174 - take '42 which seems to be the highest depreciation charges, 196, investment in Plant, Property & Equipment 128. Now, I quite realize that the depreciation charges may be said to be a bookkeeping entry, but in theory at least the result is, and assuming depreciation charges to be proper, that in six of those 8 years these companies on the average have not replaced the wear and tear on the plant?

A They have not.

(Go to Page 2996)

Q That is right is it not?

A Well that was generally because they could not buy materials.

Q No, I am talking now not about inventories. I am talking about plant, property and equipment, that is right.

A Plant, property and equipment. You could not get materials to build up the plant.

Q I am not criticising them as to why they did it but I am saying that they have paid dividends averaging 6.1%. For whatever reason there may be, perhaps because they could not buy materials, they have not taken care of the wear and tear. They have an analysis in the second column and they have not provided any fund out of which future dividends can be paid, have they? You see your allowances of everything.

A Well your depreciation account, what is that? What are they going to do with the funds they have built up in their depreciation account.

Q Look, "Use of funds". The total of these columns is equivalent to the total net source of earnings, 165 - 165.

A Yes.

Q That means in some way they have used up, in addition to their distributed profits by way of dividends, they have used up their undistributed profit, their depreciation charges and every other source of income in the way indicated in the second group, haven't they?

A No, depreciation is cash.

Q Would you look at it?

A I am looking at it. Depreciation is cash. What do you call it?

Q How do they use that depreciation allowance?

A As a reserve. They buy Victory Bonds with it.

Q As a what?

A As a reserve, they buy Victory Bonds with it. That is why we sold so many bonds.

Q You have used it as set out in the column, haven't you? Let us take 1942. Their net income, 313. I will just use the figures there. They paid out dividends 210, that is right is it not? They have undistributed profits 103. Depreciation charges, 196 and so on. There is your total of funds from current income 307. Then they add three other small items, making a total of 319. Now in that year they also used that 319 didn't they. You see the figure 319 in the bottom in red in the second group. They used the whole of the 319, didn't they?

A It says that there.

Q Well you are backing up the Bank of Canada aren't you in this thing? They used the 319. How did they use it? Investment in plant, property and equipment - 128, investment in inventories - 29, investment in other companies - 3. Investment in refundable Excess Profits Tax - 20, redemption of Funded Debt -19, redemption of preferred stock - 1. Increase in working capital ex-inventories - 125. That is right, is it not? Is not that what happened?

A I am not challenging this. You just read it out. It must be right.

Q It must be right, yes. All right now then, the fact remains does it not that in each of those years except the first two, the companies, perhaps because of inability to get equipment, material and so on, have not replaced wear and tear. Just increased their capital on occasions, I think, an increase in working capital apart from inventory. Now it has provided more cash for working capital but you still have not got any funds there, have you, for payment of

dividends? I mean they are not set aside for payment of dividends in the future.

A That unexpended portion of your net income, you must have it. Where has it gone?

Q It seems to me it has gone where these red figures are, has it not?

A Well I do not read it quite that way.

Q Well all right, let us leave it at the moment. Is that not what is happening throughout the years, that it does not matter what the income of these companies is the practical results are that dividends - I am not talking about capital gains at all, I am talking about dividends.

A What do you mean by dividends?

Q Dividends paid to shareholders.

A What do you mean by dividends?

Q Out of profits.

THE CHAIRMAN: In cash.

A In cash.

Q MR. FENERTY: Yes. I am not talking about any stock bonuses or stock splits or anything of that kind. I am talking about cash dividends, what they get as far as a return on their money is concerned by way of cash dividends and it works out at about 6.1% throughout the years.

A Yes.

Q What you really had in mind was the possibility of some stock splits or bonuses or capital gains with some of those companies.

A No, because they are not capital gains.

Q Just confine it to the one thing alone. As far as cash dividends are concerned it will work out with all of these

companies, and the best organized companies, throughout the years at around 6%. That is what happens in cash dividends.

A That is right there, is it not?

Q And that is your experience is it not?

A Well is it there?

Q That is your experience. You are an investment man and you know just how these things work out.

A You are talking to me about this official publication of the Bank of Canada.

Q Yes.

A Well, I do not see any reason to challenge it. You keep asking me if those figures are right. I assume they are right. It is an official publication of the Bank of Canada. You read them all out and you say "is that right?" and I say "it is right".

Q We have this situation, you can expect cash dividends on investments of around 6% and whether or not you get capital appreciation depends on the future, whether or not the company is efficiently managed and has good luck or not or whether it makes losses. That is the situation is it not?

A I do not know what you are getting at.

Q What?

A I have not the faintest idea what you are getting at. If you will ask me questions I will answer them.

Q Does it matter to you what I am getting at?

A I hope it does. You have not yet asked me a question. Ask me a question.

Q I want a completely unbiased answer, no matter what I am getting at.

MR. CHAMBERS: I think the witness says "I do not understand your question " in fact.

THE CHAIRMAN: Repeat the question.

BY THE REPORTER READING:

Q. We have this situation, you can expect cash dividends on investments of around 6% and whether or not you get capital appreciation depends on the future, whether or not the company is efficiently managed and has good luck or not or whether it makes losses. That is the situation is it not?

Q MR. FENERTY: Let me try to be a little clearer. It is probably my fault, Mr. Baker. We have got to the point that companies get or that shareholders of companies get cash dividends of around 6%. We have got that far, haven't we?

A If that is in the record. If that is in the Bank of Canada record.

Q Well that is, you are a financial expert, what about yourself?

A Well I will not say they would average 6% or 8% or 9%. I am going by the record here. If it is there, it is right.

Q You see that does not include every company that perhaps you deal in does it?

A Well there are six hundred odd here.

Q Mr. Baker, what I am asking you now is apart from the Bank of Canada, as a financial expert and general manager of James Richardson's, with a large experience, would you say that apart from this group of six hundred odd companies, that an average of around 6% would be a very reasonable estimate of the cash dividends that could be expected from reasonably well managed companies. If you do not know we will forget it. If you do know, tell me.

A Apart from the Bank of Canada record which I go by, I do not

know.

Q You do not know?

A No.

Q You have no personal knowledge?

A No personal knowledge, no.

Q That is all right. Now to go back to what I was trying to talk about. We will assume for a moment that 6% for these particular companies anyhow is what it pays, because we have a record, then I say that if the cash dividends are approximately 6% - and that is the record of the companies - the hope of the shareholders of making anything more than 6% dividend is in a capital appreciation with the resulting increase in the sale price of the stock of the company, is that right?

A No, it is not.

Q That, then, plus a stock dividend.

A No.

Q What other source?

A The shareholder owns the balance between what you say, 6.1 and 9.04. That is the shareholder's money.

Q And is invested in the company's undertaking in other securities.

A It might be invested in any manner.

Q Yes, but we will come back to the Bank of Canada which has been invested in increase in working capital, inventories and other securities has it not? Let us get the actual facts,

A All right, according to the record, yes.

Q Whether or not a shareholder ever gets any portion of that depends on whether or not the company operates in the future at a loss or at a profit.

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A That is right.

Q Now all right, so that whether the shareholder ever gets more than 6% on his investment is in the lap of the gods.

A Not necessarily at all.

Q Not necessarily, no.

A No.

Q Well if the company . . . . .

A They might liquidate the company. They might liquidate the company and pay him his 3.3.

Q Yes, exactly.

A Yes.

Q A company might liquidate before it makes further losses. It might continue and make large gains.

A Yes.

Q Anything of that nature. But I say the distribution to the shareholder by way of stock dividends, return on capital or undistributed profits, whether it is invested in other sources, depends on the future and how the company operates.

A That is right.

Q Nobody knows what will happen to any company.

A Well I don't.

CROSS-EXAMINATION OF THE SAME WITNESS BY MR. BLANCHARD

Q May I ask another question, sir? If on an examination of the operations of the 678 companies on page 11 of Exhibit 107, you had found that the net earnings of these companies was 5% instead of 9.04%, what would have been your recommendation as to the rate of return that Madison should recieve.

A Well I think perhaps I had better tell you how that was arrived at.

Q Well I think you have set it out in your brief.

A I did the sequence first. Before getting these figures from Ottawa, I built up that sequence, before I got those figures from Ottawa.

Q Does the 9.04% net earnings as shown on the Bank of Canada report affect your judgment as to rate of return at all that should be paid to Madison or does it not?

A It affects my judgment greatly because if the average commercial earnings of companies that are included in that list is 9.04, my judgment must be very largely based on the performance of industry as a whole.

Q And if the answer had been in the Bank of Canada statistics that the net earnings, instead of 9.4, were 5%, would not that mean that you would reduce the amount of return you recommend?

A Oh certainly.

(Go to page 3004)

Q Yes, certainly that is what I am trying to get at; now then you have said that this is not, this financial set-up of Madison is not such as to be reasonably the subject of a bond issue; now assuming that the capital is being raised to put in this gathering system and the whole installation necessary to deliver gas to Madison and keeping in mind throughout this that Madison is purely a transportation company, you understand that, it is purely a transportation company, - now then do you say that in the initial financing scheme, assuming that you are going to build this new, that it would not be a proper, that financing by a bond issue or let us say half of the money required, would be improper ?

A Definitely in my judgment it would not be proper but that need not be a complete answer. I am not suggesting that it could not be done.

Q No. Now you say that some of the reasons for that or one of the reasons is the uncertainty of the future, one of the reasons ?

A That is one reason.

Q And you say that should the field peter out ahead of the estimated life, now I think you mentioned yesterday before you recommend a gold mine you have your engineers look into it?

A Yes.

Q Now this Board has had eminent engineers looking this and this Board has had engineering advice upon which it may reasonably come to a conclusion that there is a mimimum of so much recoverable, marketable gas, so possibly we can eliminate that; in other words this Board has taken the same precautions that you, as an investment broker, take in connection with the mining industry;

Now the next: that adjacent fields as close or closer to Calgary may develop, such as Jumping Pound; you realise that in order to make Jumping Pound gas available to Calgary it would mean the installation of pipe lines, gathering lines and all the other installations necessary to delivering dry gas to the city of Calgary, have you any idea of whether, for instance, from Jumping Pound it could be done any cheaper than the existing installed, installed gathering system, a great deal of which is already subject to an accrued depreciation, have you any engineering advice on that ?

A No, no, but I have been told.

Q Or the Princess field ?

A Yes, we have been advised that it would be possible.

Q It is possible ?

A Yes.

Q Now you speak of a new and cheaper fuel being developed, you are not thinking of the atomic energy I suppose ?

A No, I think I wrote that before the atomic bomb and I did not have any advance information on it.

Q Has it occurred to you that new uses may be found for natural gas which will put its price up considerably ?

A I think, Mr. Blanchard, you are talking about something now that I would take advice on, I do not even know.

Q No, but you have given reasons and I ask you if you have taken other things into consideration ?

A Well that was the situation as I was advised on and certainly quite apart from those reasons there and other reasons, - certainly we would insist on other things generally speaking. There are others which might or might not do it, I do not know, I cannot answer for them.

Q You mentioned social changes which might have the effect of creating a shift in population ?

A Yes.

Q Well that would be injurious to a great many other types of shares, the Canadian Pacific Railway for instance, would it not, Canada Cement - -

A Oh yes.

Q A tremendous lot of these 678 companies would be affected by a shift in population ?

A Unless the C. P. R. built a better town at Okotoks or something like that.

Q Do you know that there are a thousand new houses in the course of construction in Calgary today.?

A I am glad to hear it, you certainly need it.

Q Yes, we do. Now I just want to put one other thing to you, from an investing banker's standpoint, an investors banker's standpoint, there are two main considerations as affecting his opinion of the value of a security, first, the assurance that there will not be loss of capital or undue depreciation in capital, and the second is, its earning power, those are the two things, are they not ?

A Yes.

Q Now then in industry you have the hazard of loss of markets through tariffs, competition, technological changes and so on, that is true is it not ?

A That is true.

Q Now in Madison, what hazards have you, just those you have mentioned ?

A Yes, just exactly as I have put it there.

Q All right. Now then its earning powers, here you have a market

that cannot be affected by tariff, although it might be shared at some time by competitors, that is the situation is it not ?

A Would you repeat that ?

Q I say that here you have a market that cannot be affected by tariffs, - it may be shared by others as a result of other fields coming in, - now then having regard to all those things and the hazards which relate to other companies, would you not say that Madison was a fairly desirable security for someone to hold ?

A No I cannot change my mind on that.

MR. BLANCHARD: All right. I do not think there is anything else, thank you very much.

Q DR. BOOMER: Mr. Baker, do you think that the Canadian Western Natural Gas Light, Heat & Power Company securities are desirable ?

A I have never thought so.

Q Do you know ?

A But I am learning a lot more about it.

Q Do you know what the 6% preferred are worth ?

A Oh well, probably around the call price.

Q No, they are quoted at a premium, if you can find them; how about North Western Utilities in Edmonton, do you know anything about them ?

A Yes, a little.

Q Do you know what their securities are worth, whether at a premium or less than par ?

A Oh they would be at a premium too.

Q Do you know what the 4½% bonds are, 1959 ?

A 4½%, you say around 1959, are they around 4½ and 5.

MR. HARVIE: I cannot hear, I am sorry.

Q DR. BOOMER: The North Western Utilities own a gas field and pipe line and distribution system in the City of Edmonton, They have only the one gas field - -

MR. CHAMBERS: They have only the one what ?

Q DR. BOOMER: Essentially only one gas field, the Viking-Consolidated which is 120 miles from Edmonton roughly; the life of the field as far as Edmonton is concerned, the source of supply for Edmonton, is probably greater than the life of Turner Valley so far as the Calgary market is concerned; it is not impossible that other sources of gas may be discovered closer to Edmonton than the Viking Consolidated; the risk of that happening is of the same order as the risk of it happening in Calgary; if we turn to Canadian Western Natural Gas they own, with due deference to Mr. Steer, negligible quantities of natural gas.

MR. STEER: And North Western owns all its natural gas.

Q DR. BOOMER: I put that in before, Mr. Steer. I should say that Viking Consolidated is some 200 odd miles from here ?

A From here.

Q From here, but it is only 120 miles from Edmonton ?

A Oh I see.

Q Canadian Western depends upon buying gas from Madison and at the moment - -

A Would you mind repeating that, they buy from Madison ?

Q Canadian Western buys gas, natural gas from Madison Natural Gas, and I think always will..

MR. CHAMBERS: Is that hearsay ?

DR. BOOMER: I will put it this way, they will always use Turner Valley gas so long as such gas is available and, as has been pointed out to you, Madison has a monopoly in Turner

Valley on the sources of supply, substantially a monopoly, - will you express an opinion as to the relative risks in the securities of Madison, Canadian Western and North Western Utilities ?

A No. I would if I had an opportunity of examining them and comparing the relative values but I have not had an opportunity of doing that. I may say that the opinion I have expressed is based on engineering advices which I received. Now if, as you say, the situation is just as you have put it, it might be quite interesting to look into the three of them to see what the relative values are but I do not know them.

Q Supposing I told you or let us assume that the risk of Madison losing its source of supply and its market is no different from the risk of Canadian Western losing its source of supply or its market, and bearing in mind that one is a transportation and distributing company and the other is a transportation and processing company, would there be any difference in the risk of an investment in the two companies ?

A Well assuming that you know what you are talking about - -

Q We will assume that the risk is the same.

A And putting it the way you have it is conceivable that I might change my opinion after investigating the situation as you pointed it out, and the Madison situation, quite conceivable that I could change my opinion as to the hazards. The hazard is, - the only explanation of my opinion is right there and I have given you my reasons for putting it that way.

Q Your opinion therefore is based upon information given to you by your own engineers ?

A Yes.

Q It is not based on the engineering reports that have been placed

before this Board ?

A Well, oh, that is possible, I would not know, yes.

Q Your engineer may have had access to all the engineering information which has been at our disposal ?

A Well he may have or he may not have.

Q Is he experienced in the gas business ?

A No, he may know something about it but he is not a petroleum engineer.

(Go to Page 3011)

Q Mr. McDonald put before you a hypothetical operation whereby Royalite bought a thousand dollars in each of 678 companies in Canada and I believe you told Mr. McDonald they would get, the Royalite would get, 9.04% on that $678,000.00 if they bought $1,000.00 each of these 678 companies ?

A And he said, provided they paid out all their net earnings.

Q Well is it not also true -

A Did you not also say that Mr. McDonald ?

MR. McDONALD: Yes, that is right.

Q DR. BOOMER: Is it not also true that there is an assumption that Royalite could buy a thousand dollars worth of book values in each of those companies for $1,000.00 cash ?

A Will you repeat that please ?

Q These companies paid 9.04 on their book value. In order for Royalite to get that for the $678,000.00 they would have to be able to buy in the open market $1,000.00 book value for $1,000.00 cash ?

A I am afraid I do not follow you. Could you put it another way.

Q What price would they have to pay for $1,000.00 worth of book value in the average of these 678 companies ?

A I cannot answer that. I have never seen it tried.

Q Would it be greater or less than $1,000.00 ?

A Well I will leave that to you. I have never seen the operation tried. I have never heard of the operation.

Q What is the relation of book value to the market value of securities ?

A There is no true relationship, it varies.

Q What is the average for those 678 companies ?

A I did not figure it out.

Q Would it be two to one ?

A I can give you instances of six to one, seven to one.

Q THE CHAIRMAN: What is the controlling factor. The dividend is it not with relation to the price of money ?

A That varies considerably also.

Q But it is the controlling factor is it not ?

A The amount of money they pay out by way of cash dividends certainly.

Q DR. BOOMER: In Exhibit 110, this is your submission. You set forth the analogy of Royalite acting as a banker. You suggest that the banking service that Royalite will give is both purchasing agent and custodian for the consumer ?

A That is right.

Q As a banker could Royalite also not act as safety vault for the producer ?

A Yes sir.

Q It is equally possible that Royalite might store the producers' gas until a market becomes available and charge the producer rent for those storage facilities ?

A That is I understand the idea that they handle the producer as well as their own and look after the consumer.

Q No, Royalite in this proposition pay the producer, but I am suggesting they do not pay the producer but offer storage facilities to the producer so the producer retains title just as you retain title to the stocks and bonds you put in your safety deposit box and you pay rent for the privilege ?

A That is a matter for Royalite to decide.

Q Royalite and the producer. Did you give any thought to that in preparing this ? ?

A No, frankly I did not.

[illegible]

[illegible]

- 1 -

[illegible]

[illegible] to [illegible]

[illegible]

[illegible] in the [illegible]

[illegible]

[illegible] would [illegible]

[illegible] Factor is [illegible]

[illegible] given [illegible]

[illegible]

[illegible]

[

Q You approached the problem purely from the proposition that Royalite buy and sell that gas ?

A Purely. I was not advised of any alternative.

Q THE CHAIRMAN: Mr. Baker, Mr. McDonald asked you a question and you felt you were not qualified to answer it. I am going to reduce it to a simple arithmetic problem. Assume a company had a book value, having a book value on the 31st December 1942 of $1,000.00, simple figures, earning 9% per annum on that book value of $1,000.00 ?

A Yes.

Q On the 1st of January that Company is declared to be and becomes a public utility. It invites a Board to value its property on the basis of reproduction new less observed depreciation and the resultant figure is $2,000.00 because of the book value having gone down through depreciation, the valuation figure having gone up through inflated values, then the Board is invited to allow that Company 9% per annum on its valuation. That represents an income of $180.00 or 18% per annum on its book value. Now it was declared to be a public utility in the public interest. Would any Board be justified in allowing such a rate ?

A Well putting it that way I would say no.

Q Now let me put the converse to you. Again assume a book value of $1,000.00, but this valuation was made shall we say in 1933 when we had severe deflation. The resultant value is $500.00 and the Board allowed them 9% per annum. Their income would be $45.00 or 4.5% on their book value. I think you would say that would not be fair either, would you ?

A Well if you say that this $1,000.00 you speak of, if that

[illegible]

[illegible] mostly from the [illegible]

that [illegible] but will that [illegible]

[illegible]. I can not advise or any alternative.

[illegible]: Mr. [illegible], Mr. [illegible] [illegible]

[illegible] if you were not [illegible] to [illegible] it.

[illegible] to [illegible] it is simple arithmetic. [illegible]

[illegible] a book [illegible] [illegible] [illegible] [illegible]

[illegible] at $1,000.00, simple figures, [illegible]

[illegible] [illegible] [illegible] use of $1,000.00 [illegible]

[illegible]

[illegible] [illegible] [illegible] that [illegible] [illegible]

[illegible] public [illegible]. It invites [illegible] to [illegible] [illegible]

[illegible] [illegible] [illegible] [illegible] [illegible] [illegible]

[illegible] [illegible] [illegible] [illegible] [illegible] [

is the true comparison, and there is no qualification of it that takes place just like that without services and without at all contributing factors as you say just in cold figures, it does strike me as being something that might be challenged.

Q That is right. Then go back to my original example. The public are not only paying 18% on book value but they are also paying in their service charge depreciation on $1,000.00 of inflation caused by a rise in prices. I am leading to something else, Mr. Baker, and I am sure you will agree that is not altogether fair.

A Well Mr. Chairman, is it fair for me to say that you are talking now of an accounting set-up and it is an accounting set-up which may have justifiable entries that may seem minor factors in arriving at the answer and yet are very important.

Q That is quite true.

A When you ask me that, I am not an accountant.

Q I quite agree with what you are saying and it leads me to my last question. When you are attempting to fix a rate of return for a public utility is it not the case that you cannot, no one can, express a dogmatic view of nine, or eight, seven, six or five, but that there are many, many factors to be taken into consideration before you can reach a just conclusion. Would you agree with me on that ?

A I most decidedly would agree with you, most decidedly.

Q Thank you very much Mr. Baker.

Q MR. CHAMBERS: May I ask one question arising out of that ?

THE CHAIRMAN: Yes.

Q MR. CHAMBERS: Assuming Mr. Baker, that this property

that we are talking about instead of being devoted to the public service by reason of this Act which has just passed, that it was expropriated, taken away, say the Government was going to run it and passed an Act expropriating it, and the Royalite Company or the Madison Company or whoever owned it was able to induce the Board or the Court that the fair value of that property was its reproduction cost new at present day prices, less depreciation and the Government paid that money to Madison or to Royalite whichever was the owner. Am I right in this that that money would earn in business throughout Canada 9.04% on the average. Is that a fair conclusion ?

A In their own business.

Q Assuming that they were representing business ?

A If that money were paid back into the company they should be capable of earning 9.04%. That is my argument.

(At this time a short adjournment was taken)

MR. HARVIE: We are ready with Mr. Donellan. Mr. Chairman, our submission in Volume 2, Capital Expenditures and Appraised Valuations, dated February 15th, 1945, has been filed with the Board for some time and has already been marked as Exhibit 102 in Mr. Teis' evidence. He dealt with only from Page 30 to completion. Mr. Donellan will now present the balance of the report. I might just point out at this stage that the figures obtained in this report included a great many estimates such as feet of piping, as at that time 15th February. We later filed a Supplement, Volume 1 and 2 to Volume 2 which brought those figures up to date.

A. E. [illegible]
Amer. by the [illegible].

- 10 -

that [illegible] thinking about matters [illegible] d
public service by a [illegible] on this [illegible] [illegible] d,
that [illegible] [illegible] d, which [illegible], [illegible]
[illegible] going to run it and [illegible] in not appropriating it, and
the Royalist [illegible] of the Madison Company [illegible] over d
it are [illegible] to induce the Board of [illegible] that [illegible]
value of the [illegible] and its [illegible] [illegible]
[illegible] pay [illegible] [illegible] [illegible] [illegible]
the money to [illegible] or to Royalite which [illegible]
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throughout [illegible] on the average. [illegible]
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[illegible] of [illegible]. This is my [illegible].
[illegible] this [illegible] about [illegible] [illegible])

[illegible]: [illegible] [illegible].

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[illegible] [illegible] [illegible], [illegible] [illegible] [illegible]
[illegible] [illegible] [illegible]

THE CHAIRMAN: That is dated 15th April 1945 ?

MR. HARVIE: Yes sir, with the result that there is a lot from Volume 2 that has to be discarded.

ROBERT DONELLAN, (already sworn) examined by Mr. Harvie, testified:

Q If you will be good enough, Mr. Donellan, you have been sworn and given your qualifications, proceed by reading your submission in Volume 2, Exhibit 102.

A Volume 2, February 15th, 1945, Statement of Capital Expenditures and Appraised Valuations and Working Capital. Introduction.

THE CHAIRMAN: Exhibit 102 ?

MR. CHAMBERS: I do not appear to have it in my copy.

MR. HARVIE: We filed an introductory letter to the Board which has not been completely distributed. I will see that you get that. I do not know whether the Board has a copy of this Exhibit.

THE CHAIRMAN: Oh yes I have had copies for my file of the letter of transmittal.

MR. HARVIE: I have taken a copy for the Court Reporters and given them a copy.

(Go to Page 3017)

MR.BLANCHARD: Is this now part of Exhibit 102?

THE CHAIRMAN: I have not arranged that yet, Mr. Blanchard. Do you want to make your supplement a part of Exhibit 102, Mr. Harvie?

MR. Harvie: I think it will simplify it, Exhibit 102A or part of 102.

THE CHAIRMAN: We will call it 102A.

MR. HARVIE: It will make it easier to identify.

THE CHAIRMAN: Just let us clear it up, Mr. Harvie. That which we are about to call 102A, I take it, contains all that you intend to use of 102 plus certain additions being matters brought down to date.

MR. HARVIE: Supplement 1 to Volume 2, brings it up to date, all the information contained in 102.

THE CHAIRMAN: And some of 102 will be discarded.

MR.HARVIE: Yes.

MR. CHAMBERS: And you are calling it Exhibit 102A?

THE CHAIRMAN: Yes, Exhibit 102A.

LETTER OF TRANSMITTAL OF VOLUME 2, FEBRUARY 15th, 1945, STATEMENT OF CAPITAL EXPENDITURES, APPRAISAL VALUATIONS AND WORKING CAPITAL and SUPPLEMENT NO. 1 to VOLUME 2, dated APRIL 15th, 1945, SUMMARY OF CAPITAL EXPENDITURES AND APPRAISED VALUATIONS NOW MARKED AS EXHIBIT 102-A.

THE CHAirman: All right, Mr.Donellan.

A. <u>INTRODUCTION</u>:

The following introductory comments are submitted in connection with the several statements contained herein, being Volume 2, submitted to the Natural Gas Utilities Board. The statements include the valuation of plant and equipment built for, or to be transferred to, the British American Gas Utilities Limited under the following three categories:-

(a) Capital Expenditures.

(b) Appraised Valuations.

(c) Working Capital.

The summary on Page 1 shows a total value of $893,121.07 for pipe lines, plant, equipment, etc. and consists of:-

(a) Actual expenditures to February 15th, 1945, as shown on Schedule "A".

That, I might say, is page 2, to facilitate reference.

(b) Estimated items of work in process and known future expenditures as of February 15th, as shown on Schedule "B".

Schedule "B" will be found on page 13.

At the time of preparing the statements construction was not completed. Those items which had been finalized are shown on Schedule "A" and work in process was included in Schedule "B".

In connection with the particular items:

(1)	Low pressure gas gathering and discharge lines to field compressor station	$127,110.79
(2)	Low pressure gas field compressor station	143,484.88
(3)	High pressure line from absorption Plant to Madison Scrubbing Plant	213,740.90
(4)	High pressure station and repressure system	219,399.71

These items represent the cost of constructing plant and equipment authorized under Order No. 1, issued by the Natural Gas Utilities Board, 19th June, 1944, and subsequent additions. An analysis of the various items covered by the above amounts is given on detailed Schedules, Pages 2 to 23 inclusive.

These supporting schedules show a breakdown of the major items of expense, i.e., cost of pipe, cost of laying pipe,

meters, compressors, etc. Most of the items are self-explanatory but one or two call for special comment, namely:-

Freight,Duty and Cartage:

These are the cost of these various items of expense applicable to the material shown on each schedule. In connection with this cost, submission was made to the Department of National Revenue and advantage taken to bring importation of equipment under the Wartime Regulations as a result of which refunds of duty, war exchange tax and sales tax were secured in the amount of $72,143.60.

Payrolls:

The amount for Payroll shows the actual direct charges for labour incurred in connection with the items shown on the schedule concerned.

I might interject that is British American Oil Company payrolls only. It does not include any payroll labour of contractors or subcontractors.

Field Supervision Expense:

This item covers expenses only of the Field Supervisors directly concerned with the particular item involved.

Engineer's Expenses:

Statements when prepared showed a classification "Engineer's Expenses." This is incorrect terminology. The item actually covers Construction Foreman's Expenses, that is, the expenses of the Foreman who was employed solely for supervising the construction work.

We thought it better to give the over-all correction than to attempt to go through a detailed statement.

General Administration 10%:

In each schedule there has been an addition of an over-all charge of 10% representing the charge made by The British American Oil Company Limited for services in connection with the project. These services cover the purchasing of supplies and material, legal, accounting and audit services, and a proportionate part of the Company's general overhead expenditure. This over-all charge of 10% is in accordance with the Company's policy with regard to similar projects where construction work is undertaken and is a normal and proper charge to construction costs.

Automotive Equipment $4,041.99:

Used in the Utilities operation are three trucks and a trailer which are being transferred to the Utilities Company at cost less depreciation as indicated on Page 24.

Office Equipment $747.30:

The schedule on Page 25 gives details of the cost of additional office equipment purchased for the use of the Utilities Company to be transferred.

This is additional equipment which had to be purchased for full time use of the Utilities staff.

Water System $30,050.23:

Pages 26 and 27 give the basis of valuation at which this equipment is to be transferred to the British American Gas Utilities Company. The same principle of valuation was followed for this asset as used in the valuation

[illegible]

[illegible]

[illegible]

[illegible] IV:

[illegible] Limited [illegible] [illegible] [illegible]

of the gas gathering system. It was built up from the records in the books of The British American Oil Company.

It follows the same principle of depreciation used in Mr. Teis' Report.

Existing Gas Gathering Lines $154,545.27:

This item represents the value of the gas gathering lines actually installed which The British American Oil Company Limited is transferring to the British American Gas Utilities Li ited. In order to determine a fair and proper valuation for these lines Mr. K. R. Teis made an appraisal on the basis of replacement cost less observed depreciation of the equipment. A copy of Mr. Teis' Report and his summarized schedules are included on Pages 28 to 40.

I might mention for all concerned that a gap was left there. There is no Page 40. Do not think there is a mistake about it. We got our wires crossed when figuring out the pages that Mr.Teis' Report was going to occupy. It is not an error. Then follows the summary on Page 1, and the following are detailed schedules, and with your permission I propose to go to Supplement 1 of Volume 2.

THE CHAIRMAN: That is part of Exhibit 102A?

A Yes.

THE CHAIRMAN: All right.

A INTRODUCTION:

The following introductory remarks are presented herewith with regard to statements contained in Supplement 1 of Volume 2.

At the time of filing Volume 2 certain work was

incomplete. A test operation was made and, as a result of this test, additional equipment including such items as heaters was found to be necessary for the efficient operation of the plant. On completion of the statements of capital expenditure, it was found that errors and omissions had been made and also that there had been considerable delay in receiving and approving some invoices for payment in respect of work which had been done earlier. After the plant had been in operation it was possible to estimate future expenditures which would be necessary. Supplement 1 of Volume 2 has been prepared to include corrections and additions for the above mentioned items and is submitted herewith.

A summary of actual capital expenditures to March 31st, 1945, together with an estimate of future capital expenditures, and a charge for interest during construction, (Page 1 of this Volume) now shows a total of $972,832.40.

In connection with the items included in Supplement 1, Volume 2, the following comments are submitted:-

<u>Adjustment of appraised valuations - Credit $3,111.74 - Page 1</u>:

When checking the detail of values shown in Mr. Teis' appraisal of the high pressure gas gathering lines, it was found that wrong information had been supplied to Mr. Teis in connection with the cost of installing 2", 3" and 3½" pipe. Allowance was, therefore, made correcting his appraisal value accordingly. Details of the reduction in value of $534.88 will be found on Page 3.

<u>Water System:</u>

It was discovered that errors had arisen in connection with the water system as shown in Volume 2. The intention was to value the water system on the same basis

of valuation as used by Mr. Teis when valuing the high pressure gas gathering lines. Since Mr. Teis' report was used as the basis, there is a corresponding reduction in respect of the installation cost of 2", 3" and 3½" pipe to be made. The amount of this adjustment is indicated on Pages 4 and 5, $1,777.99.

Highwood-Sarcee:

An item of cost of pipe line to Highwood-Sarcee amounting to $3,296.45 was incorrectly shown on Page 27 of Volume 2. The amount has now been deleted as the line is no longer used in this service.

Administration:

With regard to administration charges, in order to maintain a uniform basis of valuation of the Teis appraisal, an addition of 10% administration has been included. The net result of these adjustments is a reduction of $2,576.86 in the valuation of the water system.

Expenditures from February 16, 1945 to March 31, 1945 - Schedule "B" Page 6

Details of the items included in this amount are given in the supporting statements to Schedule "B". The increasse of $21,835.60 over the amount of $42,233.35 shown on Page 13, Volume 2, is accounted for as follows:-

(a)	Cost of heaters, additional valves, meters, etc. proved to be necessary	$ 18,000.00
(b)	Inclusion of items for work previously incurred, accounts for which had not been passed for payment at the time of preparing Volume 2	7,300.00

(c) Adjustment of charges for the months of September and November which had been omitted from the statement previously filed	$ 8,000.00
Total	$33,300.00
Less items included in Schedule "B", Volume 2, for uncompleted work and 10% administration	11,300.00
	$22,000.00

(Go To Page - 3025)

Estimated Future Expenditures $32,151.00:

Details of the items included in the amount of $32,151.00 are given in schedules on Pages 18-21. A summary of the items is as follows:-

Expenditures still to be made in respect of rights of way	$3,450.00
Estimated cost of laying pipe under authority of Board's Order No. 13	2,500.00
Estimated cost of changing fuel gas scrubber	2,500.00
Estimated amount of Accounts Payable in respect of work in process	10,778.00
Contingencies	10,000.00
	29,228.00
General and administration expenses	2,923.00
	$32,151.00

Interest on Capital Disbursements $28,836.47

In accordance with standard public utility procedure, interest on capital during construction has been calculated and included as an item of the cost of construction. Construction work commenced in June, 1944, and was completed by March 1st, 1945. Total disbursements in connection with new capital expenditures, to this date, amount to $728,653.85.

Interest on this amount at 9½% net (15.83% gross less Income Tax 40%) has been calculated on 50% of this amount for the six months ending December 31st, 1944, or $28,836.47. Details of this computation are given on Page 22. Advantage was taken in all cases of cash and trade discounts in respect of charges during construction.

Salvage Value:

Salvage value has not been taken into consideration in this report. Our submission in respect of the matter of salvage value will be dealt with when presenting our submission in respect of the estimated cost of operation.

Then follows on page 1 a summary of the capital expenditures, the first column being the amount brought forward from Schedule A of Volume 2. The second column are the corrections which were referred to in the report, the third column being expenditures from February 16th to March 31st, further details of which are given in Schedule B, page 6. The next column being future expenditures which it is expected will have to be made, details of which are on page 17. The next column, interest on capital disbursements and then the total column, showing total capital expenditure of $972,832.40, with the addition of Item 9, $20,000 working capital. The rest of the submission consists of details supporting that summary.

Q I note on page 2, Item 3, that you refer to the Royalite Scrubbing Plant.

A When these statements were originally prepared the headings were Royalite Scrubbing Plant and unfortunately, you will find reference all the way through to it being the Royalite Scrubbing Plant. I might call everybody's attention to that, that we mean Madison's Scrubbing Plant. Would you mind bearing that in mind when we are proceeding during the Hearing. I think in practically every case the statements which were prepared early in the proceedings, reference was made incorrectly to the Royalite Scrubbing Plant although the Madison Scrubbing Plant was intended. Do you wish to have any details. . . . .

Q I think you might go into pages 1 to 9 and make any comments that occur to you of an explanatory nature that might be helpful, if any.

A Page 2 gives the supporting information of the first column of the summary on page 1, which is summarized under Item 1.

Low pressure gathering and discharge lines to field compressor station in its three parts, main line, lateral lines and discharge lines. Other details are given on pages 3, 4 and 5 coming down to the actual material.

Q That is pages 3,4 and 5 of Volume 2.

A Yes.

Q Not 2A?

A No, not 2-A. Then low pressure gas field compressor station is broken into its two parts, compressor and compressor station.

Item No. 3 is just another summary of the high pressure lines from the Absorption Plant to Madison's Scrubbing Plant. Then high pressure compressor station and repressure system being Item 4 breaks it down into its 4 component parts, compressor, station, repressure line from station to Sovereign junction and part 4, repressure lines connecting Pacalta, Carleton and Sovereign.

Item 5 shows the detail of the automotive equipment. Item 6, office equipment; Item 7, water system, appraised valuation and Item 8, existing gas gathering lines. That schedule is just a copy of the one which appears in Volume 2.

Page 3 gives the detail of the correction referred to in the introductory comments of $534.88. I explained that arose through Mr. Teis being given some wrong information from our office and the Gentry engineers. They did not think that prices were quoted in the contract for those smaller diameters of pipe and the superintendent gave him the figures offhand. It was found later that the prices were in the contract on Page 8 of the Gentry contract and this is the necessary

correction to give effect to it.

Page 4, the top section of the Schedule, shows the original summary as per Volume 2 of the $30,000.00 being the value that was put in that statement as the value of the water system. Item A referred to the inclusion of the Highwood-Sarcee pipe. Somebody in our office thought that was the Highwood River pipe and so it was taken out. Item B corrects the $1,777.99 and the corresponding corredtion is similar to the one that was referred to in the report. Item C is the addition of supervision and administrative charges.

Page 5 gives a more supporting detail of the Item $1,777.99 shown on page number 5.

Q On Page 6 there does not seem to be any special comment.

A Page 6, that is just a summary, really, restating the three columns of the summary into the main section.

Q On page 7 I notice an adjustment shown there of $1,888.51. Will you explain that?

A That is one of the errors I was referring to when the original charges had been made incorrectly to the account involved in the deduction and $1,888.51 was taken from the field compressor station on page 7 and added to the field compressor station on page 8. It is a transfer as between main lines and lateral lines.

Q It is a low pressure gathering line and runs to the station on page 8?

A Yes.

Q Any further comments on pages 8 and 9?

A There are footnotes there and on page 8 it shows where the offsetting adjustment is made on page 12 and footnote B shows where the offsetting corrections are on pages 11 and 14.

Pages 9, 10, 11, 12, 13 and 14, and up to page 16, they are just supporting, giving details of the items referred to in the previous summary. Page 17 shows the details of the estimated future expenditure contemplated in the amount of $32,151.00. Item number 1 is broken down. This is a summary sheet and the details are found on the following pages. Low pressure gathering and discharge lines to field compressor stations, there is an item $6,930.00, made up of $2,145.00, an item for the main line; $4,565.00 for lateral lines and $220.00 for the discharge lines. More details are shown on page 18. Similarly for the low pressure gas field compressor station, a total of $6,844.00. That is analyzed on page 19. Item 3, $6,418.00 in connection with the line to the Madison Scrubbing Plant is detailed on page 20 and $11,959.00 referred to in the summary for the high pressure compressor station and repressuring system, the details of that account are shown on page 21. Page 22 gives details of the computation in connection with the charge for interest during construction.

MR. CHAMBERS: Mr. Harvie, on page 17 it says here: Part 1, high pressure lines, page 20, $6,418.00. Then turn to page 20.

A The following pages. Details of that $6,418.00 are found on page 20.

Q Oh yes, I missed it. I am sorry. I was referring to the other exhibit.

Q MR. HARVIE: Refer back to Volume 2, exhibit 102 and there are still several pages at the end following Mr. Teis' report I think might be referred to. Starting at page 41.

A Yes, on page 41 of Exhibit 102 details are given of the

$20,000.00 of working capital. On page 42 there is a statement breaking down the investment by the various functions of the plant as between gas gathering lines, low pressure compressor stations, high pressure lines and high pressure compressor station and repressure system, water system and sundry.

Page 43 is a similar allocation of how we have applied the working capital to the various parts of the system. This was to facilitate statements in connection with operating expenses. Similarly page 44 shows the breakdown of the automotive equipment and the office equipment to the various operating sections of the system. Reference should also be made here that on page 24 of Volume 2 it gives the details of the automotive equipment which has been transferred and 25 gives details of the office equipment.

Q If you will refer to page 1 of volume 2, supplement 1, there are 9 items. First, low pressure gathering and discharge lines, field and compressor stations and so on. Am I right in stating all these items excepting 7-water system, 8-existing high pressure gas gathering lines as per K. R. Teis' appraisal and 9-working capital are items that were incurred under the direction of the Board.

A Yes.

Q And those were actually new capital expenditures?

A Not exactly. The automotive equipment, while it was an actual expenditure from the utility point of view, was a transfer of all our equipment from the British American Oil Company.

Q On the basis of valuation?

A On the basis of valuation which is shown.

Q Then the water system, Item 7, and Item 8 are old units that have been taken over into the new system?

A Yes.

Q And are valued on the basis of Mr. Teis' valuation and working capital is your estimate?

A Correct.

Q Now in connection with the valuation of the old units taken over, which include the water system and the high pressure gas gathering system valued by Mr. Teis, have you made any other check as to those valuations other than that of Mr. Teis?

A Yes. On the receipt of the Teis report, I naturally wanted to satisfy myself as to whether the amount was correct or if I wanted to make any comments on it. So my first test was to make a comparison with the other submissions which had been filed. I took first of all his overall gauge, the total footage of pipe which was installed in the B.A. system and the total footage of pipe which was reported in the Madison submission and I find that the valuation of the Teis appraisal came to 2.135 dollars per foot and under Madison it came to 2.232 dollars per foot.

(Go to page 3032)

Q MR. BLANCHARD' Will you give us those figures again?

A Yes, the Teis' 2.135 dollars per foot. The Madison, 2.232 dollars per foot. That seemed to be a fair over-all comparison and yet I was not able to satisfy myself that they were comparable systems as between various diameters of pipe and there did not seem to be any means of reconciling the one to the other so as a further check I took the footage of pipe reported by Mr. Teis, then I applied to Mr. Teis' footage the values shown on the Madison statement both for the pipe and the installation costs. That gave me a total of $146,000, if I remember rightly, and I applied the same proportionate depreciation but I did not make any allowance for injuries during construction or going concern, so I felt it was 94 or 95 per cent. That supports the Teis valuation and I just accepted this 154,000 and applied the same basis of valuation then on the water system.

MR. HARVIE: Have you any further information? that you wish to give on that?

A I think that sums it up. I want to make it clear that the water system was not appraised by Mr. Teis at all. At the time the instructions were given to Mr. Teis, the question of whether we should transfer the water system to the utilities had not been discussed but by the time we were preparing these statements we wished to value the water system so I used the same principle of valuation as in the Teis report and applied it to the book records of the water system but the valuation of the water system is entirely our own office work. Mr. Teis had nothing to do with it at all. I think that is all I can say.

MR. BLANCHARD: Can we have these computations

put in, these comparative figures between Madison and Teis?

WITNESS: I can prepare the statement. It is in the shape of working sheets now but I can have them typed and brought over.

Q MR. BLANCHARD: It would not be a great deal of labor, I suppose.

A No, it would not.

MR. HARVIE: No, we will do that.

Q MR. HARVIE: In that connection on the 11th instant in Mr. Blanchard's examination of Mr. Teis, he took a definite illustration or he took a figure of $1,489.18 as Mr. Teis' costs and applying similar figures on the basis of Mr. Hill's valuation he came to a much lower figure, can you explain whether that is a fair comparison or what the difference is?

A Well I can only say, show the mechanical difference between $1,489.18 from $580.00. I submit that the over-all tests which I have previously applied, that answers the question that while there is a figure of 9,56 which was correspondingly higher than that of 4.146 in the Madison report, that there were other items of expenditures. I have not made any detailed comparison than the fact of applying the Madison value of 4.14 but I was satisfied . . . . .

Q You were satisfied that it brought it close to line.

A It is so close in line that I did not go further.

MR. HARVIE: Yes, and that is in connection with the over-all costs.

A That is right.

MR. HARVIE: Now, Mr. Chairman, shall we proceed with our further submission on operating costs, will we go on and get that all in or do you wish to proceed with the

cross-examination on this point.

THE CHAIRMAN: I think probably that would be the better thing to do, to cross-examine on this point and then go on to the next one. I know it is much simpler when reading the transcript, than if you do otherwise. Of course if we cannot do it, if it is impossible, that raises the question then is anyone ready to cross-examine on this particular point?

MR. HARVIE: Outside of the working papers we are prepared to go ahead.

THE CHAIRMAN: Gentlemen, what do you wish to do?

MR. STEER: My cross-examination, sir, is of a general nature and may not be perhaps specifically related to these items except incidentally.

MR. BLANCHARD: Mr. Chairman, before cross-examining on these comparative costs of gathering lines and installing costs as between Madison and B.A., I think we should be furnished with the figures prepared by Mr. Donellan, or which are going to be prepared, because it is quite an important item and I think there will have to be a comparison of the sizes of pipe and the character of pipe to make it intelligent at all.

Q THE CHAIRMAN: Well you cannot furnish those figures today, Mr. Donellan.

A They are in working sheet form now, it is just a matter of having them typewritten.

Q When can you have them ready?

A I can have them ready, I think, this afternoon.

THE CHAIRMAN: Well we will be adjourning today anyway.

MR. HARVIE: And I will be very glad to have them distributed to counsel as soon as they are prepared,

which may possibly be tomorrow.

MR. CHAMBERS: It would save time in cross-examining if we had them ahead of time.

THE CHAIRMAN: You will have them in plenty of time so that you will be ready to cross-examine on Tuesday, so you had better go ahead, Mr. Harvie, with another submission now.

Q MR. HARVIE: Volume 3, Supplement 1 and the same general remarks apply to the relationship between Volume 3 and the supplement to volume 3 as applied to Volume 2 and Supplement 2. Supplement 3 is the original.

THE CHAIRMAN: Can we discard the first Volume 3 aand deal only with Volume 3 supplement, or is there still some material in Volume 3 which you may require?

MR. HARVIE: I think possibly I had better have read the letter of transmissal. This will be Exhibit 113.

THE CHAIRMAN: Exhibit 113.

SUBMISSION VOLUME 3 PRODUCED HERE MARKED EXHIBIT 113.

MR. HARVIE: And then volume 3, supplement 1.

THE CHAIRMAN: Volume 3, supplement 1, I think we had better call that Exhibit 113 (a).

SUBMISSION VOLUME 3, SUPPLEMENT 1, PRODUCED HERE MARKED AS EXHIBIT 113(a).

Q MR. HARVIE: Will you deal with that, Mr. Donellan, with Volume 3?

A Estimated cost of operations, volume 3, February 26th, 1945.

Introduction:

The statements contained herein provide a summary of the estimated cost of operations. Page 1 shows, by years, the estimated total annual cost of operations with the average

monthly payments required for the period 1945 to 1954 inclusive. The amortization of capital expenditures and appraised valuations is based on a straight line depreciation of 10% per annum and the return on investment at 9½% net, that is, after providing 40% income tax.

It will be appreciated that in the case of the British American Gas Utilities there is no precedent to use in the preparation of these statements. They are built up from careful estimates prepared by the Engineering and Accounting staffs.

Operating Costs:

Page 2 gives a summary of the various types of expense included inthis item such as labour, repairs and maintenance, etc.

Administration Charges:

An administration charge of $15,000 per annum has been included in the operating cost statement representing an estimate of the proportion of overhead charges which will be levied by The British American Oil Company Limited, for supervision of the operations of the Utilities Company. Here again, there is no definite precedent established but from experience of the Company's other operations, it is felt that the estimated amount of $15,000 will be justified in practice. This charge is intended to cover the items outlined on page 3.

Amortization of Capital Expenditures and Appraised Valuations:

Details of the amount shown on the summary are given on page 4. An amount of the estimated salvage value at the end of the ten years has not been included in the statement submitted. It is recognized that this matter must receive

consideration before the termination of the ten-year period. It is difficult, and in our opinion practically impossible, to estimate adequately the salvage value of equipment ten years hence. Engineering and scientific development during the ensuing decade cannot be forecast. It is estimated that a revision of rates will undoubtedly prove to be necessary and that in six to seven years hence a more reasonable estimate of salvage value could be determined. In the meantime, amortization of capital expenditures and appraised valuations has been calculated on a straight line basis for the estimated period of operations, namely, ten years.

The fact of eliminating consideration of salvage value at this time does not penalize the users of gas during the early years and bonus the users in the latter years. It is submitted that the net amount is not sufficiently large to render any serious injustice. Assuming a salvage value of $50,000, that is, 5%, there would be a decrease over ten years of $50,000 or $5,000, per year in the amortization charge but on the other hand there would be a corresponding increase in the amount of return on investment.

Return on Investment 9½% net:

A rate of 9½% net has been used in the estimated cost of operations as being a fair return in view of the short term life and the nature of the operations. Compared with other public utility operations in the Province of Alberta, namely, the Gas Company with a comparatively stable operation for several times the period involved, with a net return, we understand, of 8½% and the Valley Pipe Line, which again has a greater contemplated life than ten years, with a rate of 8%, we believe 9½% to be a just and fair rate. The return on investment has also been included on the

amount of working capital involved, namely, $20,000.

I might say that I have since learned, I had that report dictated down in Toronto and I was going from memory, that item was 10% originally and it was not 8% until some time subsequently.

The amount of working capital has been calculated as being the stock of spare parts for compressor stations $6,600 plus sixty days' operating expenses including administration $13,400.

Departmental Expenses:

Pages 5 to 7 inclusive show a summary of the operating cost divided between

(a) High pressure gas gathering lines.

(b) Low pressure gas gathering lines.

(c) Low pressure compressor station.

(d) High pressure compressor station.

(e) High pressure line to Madison Scrubbing Plant.

(f) Repressuring lines.

(g) Water system.

Pages 8 to 11 inclusive show a breakdown of the operating expenses, administration, amortization of capital expenditures and appraised valuations and return on investment over the various departments concerned.

It will be appreciated that the statements included in Volume 3 represent the gross cost of operations. No attempt has been made to allocate the division of this cost as between the amounts chargeable against gas sold to the market, transportation services for the G.O.P. The British American Oil Company Limited in connection with gas gathering lines, the use of water, or any other allocation of charges

which may be ordered by the Board. It is merely a statement of the estimated cost of operations.

Then follows the index of the various statements. Page 1 is a summary of the estimated cost of operations. . . . .

Q Have you read the summary, no, I suggest you now go on with the supplement to Volume 3.

A Very well, perhaps it would be better than going on with this here.

Supplement 1 to Volume 3 is dated May 22, 1945.

The statements contained herein are a revision of the statements shown in Volume 3. Volume 3 was prepared in February at which time various items of construction had not been completed. It was necessary, therefore, to file a supplement to Volume 2 adjusting estimated amounts to actual costs. This, necessarily, caused a change in the proposed rate base thereby altering the amount of amortization and also the amount of return on investment as shown in Volume 3. Supplement 1 to Volume 3 is submitted herewith, the statements being adjusted to provide for the change in the amount of capital expenditure in Supplement 1 to Volume 2.

Return on Investment:

When preparing Volume 3, the return on investment was taken on a basis of the opening balance. In order to reflect greater accuracy in this item the return on investment in Supplement 1 to Volume 3 has been calculated on a weighted basis similar to other submissions filed.

Then there follows the index.

Page 1, a summary of the estimated cost of operations for each of the years 1945 to 1954, the total amount of funds required to operate the system, broken

down as between operating costs, administration charges, amortization of capital expenditures, net return on investment, the total amount average monthly payment required. Page 2 breaks down the annual charge of operating costs into its component parts of labor, repairs and maintenance, lubricating oil, field management and supervision, taxes, etc.

Page 3 outlines the items which are included under "administration".

Page 4 shows the working out of the amortization charge at $97,283 per annum.

(Go to page 3041)

Page 5 breaks down the estimated cost of operations as between the high pressure gas gathering line and the low pressure line and low pressure station for each of the ten years.

Page 6, is a continuation of estimated cost of operations for high pressure compressor station, high pressure line to Madison and repressuring lines.

Page 7, shows the operating costs, administration, amortized capital expenditures and return of investment incidental to the water system for each of the years 1945 to 1954.

MR. HARVIE: I do not know whether we are gaining anything. I think they are all self explanatory.

A They are almost self explanatory. It is a question of whether Volume 5 is not part of the Supplement Volume 1 to Volume 3. It is an extension of the Supplement, Mr. Chairman.

MR. HARVIE: Volume 5 covers gas gathering operations divided into the headings indicated.

THE CHAIRMAN: That will be an Exhibit.

BRITISH AMERICAN GAS UTILITIES LIMITED ESTIMATED COSTS MAY 22ND, 1945, VOLUME 5, NOW MARKED EXHIBIT 113 B.

MR. HARVIE: I would say when we prepared Volume 3, Supplement 1, Volume 3, we restricted the estimate of costs of operations just to a picture of the total operation irrespective of the allocation for the various uses. It was always felt we could extend that and give a supplement breaking down those costs to the various operations.

A Volume 5 is the estimated costs of (a) gas gathering operations, (b) gas transmission operations, (c) gas repressuring operation, (d) water system operations.

Toronto, May 22, 1945.

Introduction

This report, being volume 5 of our submissions, contains an estimated break-down of the estimated cost of operations figures reported in Supplement 1 to Volume 3, in order to show "A" Estimated Cost of Gas Gathering Operations, "B" Estimated Cost of Transmitting Gas to Madison Scrubbing Plant, "C" Estimated Cost of Gas Repressuring Operations, "D" Estimated Cost of Water System Operations.

Pages 1 and 2 of this submission are the summary sheets showing the estimates for :

"A" Cost of Gas Gathering, which includes the cost of compressing and the portion of water costs applicable to the low pressure compressor station operations.

"B" Cost of Transmitting or Delivering Gas to Madison Scrubbing Plant. These figures also include the cost of compressing and the portion of water costs applicable to the high pressure compressor station operations.

"C" Cost of Repressuring Gas - here again the figures include the cost of compressing and the portion of water costs applicable to the high pressure compressor station operations.

"D" Water System Operating Costs - these figures exclude 25% of the cost of operations which has been included in items "A", "B" and "C" above. We estimate 25% as being the percentage of volume of water used at the two compressor stations.

Column 1 - "Operating Costs" and Column 2 - "Administration": Details regarding the break-down of these figures are shown on page 4 of this volume.

Column 3 - "Amortization of Capital Expenditures"; Details of the break-down of capital expenditures and appraised valuations are shown on page 3 of this volume. Here again, as in our other submissions, we have used a straight line write-off for a period of 10 years.

Column 4 - "Return on Investment - 9½% Net": Details of the calculations are found on pages 5 and 6 of this volume.

Column 5 - shows the Total Estimated Cost of Operations.

Column 6 - "Revenue from Gas Handled ex G & O. R. Ltd." shows the estimated revenue from transmitting gas from Gas and Oil Refineries Limited to Madison Scrubbing Plant - details of the make-up of this figure can be found on page 8 of this volume.

Column 7 - "Revenue from B-A Oil Co. Ltd. for 15% of Operating Costs of the Gas Gathering Lines". This represents the estimated cost of operating Gas Gathering Lines applicable to the volume of gas:

(a) lost in Absorption Plant operations 10%

(b) used in Absorption Plant as fuel 5%

Details of this figure are shown on page 7 of this volume.

Column 8 - "Revenue from B-A Oil Co. Ltd. for 75% of Operating Costs of the Water System". It has been estimated by our engineer and plant manager that 25% of the water through the water system is used at the two compressor stations run by the B-A Gas Utilities Limited and 75% used by The British American Oil Company Limited Absorption Plant. Further details of this figure can be found on page 7 of this volume.

Column 9 - Shows the Total Cost of Operation after deducting the revenues shown in columns 6, 7 and 8.

Column 10 - Shows the Average Monthly Payment Required to cover the cost of operations.

Pages 3 and 4 allocates Capital Expenditures and Appraised Valuations, Working Capital, Operating Expenses and Administration to the four systems covered in this submittal.

Pages 5 and 6 contain tables showing Amortization of capital expenditures and Appraised Valuations (as reported in Supplement 1 to Volume 2) and calculation of Return on Investment.

Page 7 gives details of charges to The British American Oil Company Limited.

Page 8 gives details of the charge for transmitting gas from Gas and Oil Refineries Limited to the Madison Scrubbing Plant.

When compiling these figures the operating costs of the high pressure compressor station were divided between the cost of transmitting gas and the cost of repressuring gas on a basis of estimated throughput - (Transmitting Gas 42% - Repressuring Gas 58%). The cost of water was divided between the two compressor stations on a basis of H. P. rating (L.P. Compressor station 10.75% - H. P. Compressor Station 14.25%)

Supporting details are merely an extension of the figures in Volume 3 of the Supplement with a credit for the services rendered to the B. A. Oil Company and G. O. P.

Q MR. HARVIE: Have you any special comment to make on any of the other pages or are they self explanatory ?

A I think they are self explanatory.

Q MR. HARVIE: That will complete our written submission,

Mr. Chairman, I do not know whether there is anything to be gained by using up the few minutes in cross-examination.

MR. FENERTY: I am not prepared to cross-examine now.

THE CHAIRMAN: You must remember Mr. Donellan has to leave here next Thursday night and I also have something else for Thursday and we have twenty minutes that can be usefully used in cross-examination.

MR. BLANCHARD: May I ask , Mr. Chairman, whether the operating costs for the first six months of 1945 are available, the actual record of operating costs ?

A Our proposal is filed for the seven months and unless you want the six months which is a matter of typing. They will be available tomorrow morning. Seven months would be satisfactory Mr. Blanchard.

MR. BLANCHARD: Yes.

THE CHAIRMAN: Perhaps Mr. Steer you could do your general questions today.

MR. STEER: Yes.

CROSS-EXAMINED BY MR. STEER:

Q You have told us you have been connected with the British American Oil Company since 1930 ?

A Yes.

Q And I take it then you have a pretty detailed knowledge of the affairs of the Company. Is that right ?

A Well I was internal Auditor for several years and I have been Chief Accountant for the last three years so I should have.

Q Are you able to tell us when this British American absorption plant was erected ?

A 1936.

Q And was it a new plant when it was first erected or were second hand materials used in it ?

MR. HARVIE: I was wondering whether this has anything to do with this inquiry. I do not know that any detail of the absorption plant as such has anything to do with the inquiry at this stage. Those assets that were taken over by this utility from the absorption plant, yes.

MR. STEER: I propose to present to the Board a submission that notwithstanding the severance of the absorption plant from the balance of the property that this Board should look into the undertaking as an integrated undertaking.

THE CHAIRMAN: In other words you are not directing this cross-examination to any particular inquiry into the absorption plant but rather as it may apply to the whole original operation and for the purpose of dissection.

MR. STEER: Quite so.

THE CHAIRMAN: Oh I think we will have the evidence if it is available and you can rely on us, Mr. Harvie, not to get our minds confused with irrelevancies if there are any -

MR. HARVIE: I may be wishing to speak after I hear some more questions as to type of evidence that is going in.

A Are you referring Mr. Steer to the absorption plant as a plant or the gas gathering line they have taken over ?

MR. STEER:

Q Let us have them both. Where did the material for the construction of the absorption plant come from ?

A Well I am not - I can only give it to you from memory. I cannot refresh myself on it. A certain amount of new material, some pipe was second hand pipe.

Q I am talking about the plant itself.

A The plant itself, some came if I recall correctly from the

plant we had at Coutts. Some of it was new, a combination of new and old.

Q And the plant that you had at Coutts, was that a new plant when erected or a second hand plant ?

A That was a plant which we took over from another company.

Q And how old was it when you took it over ?

A I have no idea.

Q Then you took that old plant and you moved what you could of it up to the location of the present plant in 1936, and you added some new materials and that is the building as it exists today subject to any intervening depreciation and wear and tear. That is right ?

A Yes, that is right.

Q And I gathered from Mr. Tois evidence that the gathering system that you built connected with that plant was much the same. Old stuff, with some, mostly old stuff with some new stuff added.

A Well gas gathering systems, some of it was installed in 1936. There was a steady growth in additions to it.

(Go to Page 3048)

Q Yes. On your having constructed that B.A. plant you had no wells of your own in that area?

A I do not know. From memory I will say I believe not, but I am not prepared to say definitely.

MR. HARVIE: If you do not know just say so.

Q MR. STEER: And your plant operations then were carried on by virtue of contracts made between your company and oil well operators in the area, is that right?

A That is right.

Q 1936 is the year in which crude oil was first discovered in the Turner Valley area?

A Correct.

Q Is that right?

A Yes.

Q Are you able to tell us how many wells were operating in that area prior to 1936?

A No.

Q Is that information available?

A I have not got it.

Q Can you get it?

MR. McDONALD: It will be in the Conservation Board's report.

A WITNESS: I shall have to find the source of material which I believe will be the Conservation Board's report.

DR.BOOMER: Those reports have been filed.

MR. STEER: Pardon?

DR. BOOMER: Those reports have been filed.

Q MR. STEER: Then the purpose - perhaps I will ask you this first: The product of any wells that were in

existence prior to 1936 would be naphtha?

A I do not know.

Q You do not know?

A No.

Q Will any other official of your company connected with the operating department be in the box, do you know?

A I do not know that.

Q Do you know whether the construction of this plant was in any way connected with the discovery of crude oil in 1936?

A I think not. My memory says that this was built on the assumption of the Turner Valley gas field.

Q It was built what?

A On the assumption of it being a gas field, or naphtha.

Q Gas field?

A Gas and naphtha.

Q Pardon?

A Gas and naphtha.

Q Yes. And by a gas field you mean a gas and naphtha field?

A Yes.

Q Now, Mr.Donellan, it must be true that your original plant in 1936 was built for the purpose of recovering the naphtha from that gas that was available prior to that year plus such additional naphtha as could be got from any crude oil wells in the area that were connected up to your plant, is that right?

A I do not know. It sounds reasonable.

MR.HARVIE: Mr. Steer, I think you mean absorption product. Naphtha is the product from the separator which the absorption plant does not include.

Q MR. STEER: It is true that from 1936 up to

the present time all the residue gas from that plant was burned?

A Not all, some of it was sold for drilling fuels.

Q An insignificant amount?

A Yes, quite.

Q Was sold for drilling fuel and all the rest of it was burned?

A Correct.

Q It follows then that your plant plus your gathering lines from 1936 on to the present time were built for the purpose of recovering the gasoline content from the gas in that area?

A Yes, I think that was the primary reason.

Q Yes. And consequently that description that you made of this field as a gas and gasoline field would not be an accurate description?

A I did not say gas and gasoline.

Q What did you say?

A Gas and naphtha.

Q Gas and naphtha?

A Yes.

Q That could not be an accurate description that all the gas from 1936 on was burned in the air, could it?

A I think in that year.....well we might be at cross-purposes there. It was built as a gas field, a gas and naphtha field, with the idea of taking the absorption content out of the gas.

Q Quite so?

A Yes.

Q That is what you meant by that?

A Yes, that is what I meant by that.

Q You did not mean a field developed for the purpose of recovering natural gas that could be furnished consumers to be burned

in their furnaces or stoves?

A I had no reference to the gas field in that sense.

Q Yes. So that we are at cross-purposes. And so that really what you say is that your installations there originally were for the purpose of recovering the remaining gasoline that was in that natural gas after it left the separators at various wells, whether gas wells or crude oil wells?

A That was the original use of the plant.

Q Yes. And for that purpose you erected the high pressure gathering system which Mr.Teis has valued for us, is that right?

A Correct sir.

Q And it was built for that purpose and for no other purpose?

A Built for that purpose at the time it was built. I do not know what the engineers had in mind.

Q Have you any idea of the volume of gas that was burned in the intervening years from 1936 on?

A I have the information available but not with me, I am afraid. I can get it for you.

Q Perhaps you will get that for me.

Q THE CHAIRMAN: Mr.Donellan, perhaps - the thought just occurred to me, what had you in mind when you had the 50% provision in the contract with regard to the natural gas?

A Well I had nothing to do with that. I believe that it was to be divided, it was to be divided 50-50.

MR. HARVIE: We propose very definitely when the time comes on the absorption operations to bring considerable evidence on that point. If it would be of any assistance in this part of the Inquiry, I do not think we will have any objection to giving some reasons for it.

[illegible]

THE CHAIRMAN: Well we won't go into it now, but I thought perhaps Mr. Donellan was overlooking something.

MR. HARVIE: That was very good of you, because I was just hoping that the point would come out.

Q MR. STEER: I suppose perhaps we will have that contract before us some time before the end of the hearing. I have not yet seen one. There is a term in the contract isn't there, Mr. Donellan, that if the residue gas is used for any purpose then the proceeds of the sale of it are to be divided between your company and the producers of the gas?

A Correct.

Q Is that right?

A Yes.

Q And is that provision, as I understand it, 50% to each?

A 50% to each.

Q I see. And up to date you have not found any market for the gas apart from this trifling quantity of drilling fuels that would cause you to bring that clause of your contract into play, have you?

A That is right.

MR.HARVIE: Up to what date?

A THE WITNESS: Since the operations of this utility it is a different matter.

Q MR. STEER: Yes. And is your transmission line from your present absorption plant to the Madison scrubber operating now?

A Transmission line?

Q Yes?

A Yes.

Q And for how long has that been operating?

A Some time in December 1944.

Q Yes.

Q DR. BOOMER: By the way, you have not got that contract here have you?

THE CHAIRMAN: With the 50-50 clause in it.

A THE WITNESS: I will have to look it up . In the vast majority, I think, every one of our contracts are 50-50.

Q DR. BOOMER: But all the gas you handle is under a contract?

MR. HARVIE: All that is being handled now is being handled on that basis.

Q MR. STEER: Have you contracts with every producer of gas that would be naturally tributory to your absorption plant?

A Either a contract or an agreement which covers it.

Q What distinction do you draw there?

A It is running through my mind that one or two did not the contract as such but were willing to operate under the same effect as though they had a contract. I ight be incorrect on that

Q I see. In other words, you had a verbal contract embodying the same terms as the one?

A Yes.

Q I see. Now, it is quite clear that all this high pressure which is being turned over to B.A. Natural Gas Utilities, if I give the Company its correct name, was installed for the purpose that you have told us of processing gas as it came from the separators at these wells, that is right?

A That is right.

Q Yes. Are you in a position to tell us what the volume of gas is that might have been expected to pass through that

B.A. absorption plant from your area?

A No.

Q As of, we will say, the 1st of January, 1945?

A That is, dealing with the capacity of the field and the amount available?

Q Yes?

A No, I am not competent to say.

Q I would like to have that information, Mr. Chairman, if I may. I would like to be advised as to that, or I would like the witness to inform himself.

THE CHAIRMAN: Will you get that, Mr. Harvie?

MR. HARVIE: Yes.

MR. STEER: As to the quantity of gas that would have been expected to pass through the absorption plant from the 1st of January, 1945 to the end of its life, and, secondly, I would like to get.....

MR.HARVIE: Just excuse me. Pass through the absorption plant from?

MR. STEER: The high pressure system.

MR. HARVIE: The high pressure system?

MR. STEER: Up to the end of the life of the field.

MR.HARVIE: From when?

MR. STEER: The 1st of January, 1945. And I would like also to get the quantity of gas that is added to the system, expected to pass through the absorption plant by reason of the construction of the low pressure system. And I may say that, from the evidence given by Mr. McCutchin, I calculated that those quantities would be 20 billion cubic feet in the one case, or the quantity that might be expected

to pass through the absorption plant under the high pressure system, and an additional 30 billion cubic feet added by reason of the low pressure system.

Q And I would like you to do, Mr. Donellan, if you will, to check up those figures and tell me if I am right?

A All right.

THE CHAIRMAN: Adjourn to Tuesday morning, at half past nine.

(The Hearing was then adjourned to 9.30 A.M., September 18th, 1945).

Robert Donaldson,
Green-Taxes by Mr. Asbury.

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To pass through the Assembly which under the Ward Government System, had not authorized the Wardens order that adopted by Council of the low pressure channel.

Can I trouble him to do, Mr. President, if you will, to check up those figures and hand up to me tomorrow night.

MR. CHAIRMAN: Adjourn to Tuesday morning, at half past nine.

(The Meeting was then adjourned to 9.30 A.M., Tuesday, 18th, 1921).